

2005**Investment Interest Expense Deduction**

Attach to Form 540, Long Form 540NR, or Form 541.

3526

Name(s) as shown on return

Social security number or FEIN

1	Investment interest expense paid or accrued in 2005. See instructions	1	0010
2	Disallowed investment interest expense from 2004 form FTB 3526, line 7. If zero or less, enter -0-	2	0020
3	Total investment interest expense. Add line 1 and line 2	3	0030
4a	Gross income from property held for investment (excluding any net gain from the disposition of property held for investment). See instructions	4a	0032
4b	Net gain from the disposition of property held for investment. See instructions	4b	0035
4c	Net capital gain from the disposition of property held for investment. See instructions	4c	0040
4d	Subtract line 4c from line 4b. If zero or less, enter -0-	4d	0042
4e	Enter all or part of the amount on line 4c that you elect to include in investment income. Do not include more than the amount on line 4b. See instructions	4e	0044
4f	Investment income. Add line 4a, line 4d, and line 4e	4f	0046
5	Investment expenses. See instructions	5	0050
6	Net investment income. Subtract line 5 from line 4f	6	0060
7	Disallowed investment interest expense to be carried forward to 2006. Subtract line 6 from line 3. If zero or less, enter -0-	7	0070
8	Investment interest expense deduction. Enter the smaller of line 3 or line 6. Form 541 filers, stop here and see instructions. All other filers, go to line 9	8	0080
9	Enter the amount from federal Form 4952, line 8	9	0082
10	California investment interest expense deduction adjustment. Enter the difference between line 8 and line 9. See instructions.	10	0084

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information regarding California and federal law, visit our Website at www.ftb.ca.gov and search for **conformity**. Additional information can be found in FTB Pub. 1001, *Supplemental Guidelines to California Adjustments*, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

Note, the instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

For tax years beginning after December 31, 1992, under federal law, net capital gain from the disposition of property held for investment is excluded from investment income when figuring the investment interest limitation. However, taxpayers may elect to include in their investment income as much of their net capital gain investment income as they choose if they also reduce the amount of net capital gain eligible for the special federal capital gain tax rate. California conforms to this federal provision for taxable years beginning on or after January 1, 1997.

This form allows you to make a separate California election to include net capital gain

investment income in the calculation of the investment interest limitation. However, California does not have a special capital gain tax rate (all income is taxed at the same rate), and you should consider the effect on your California tax before making a separate California election or applying the federal election for California purposes.

For taxable years beginning on or after January 1, 2002, California law was changed to clarify the method used to calculate loss carryovers, deferred deductions, and deferred income for nonresident and part-year residents. This changed the tax computation to recognize those items, and established a new method to determine percentages for computing tax for all nonresidents and part-year residents. The nonresident tax forms (Long and Short Form 540NR) have been revised to more clearly show that nonresidents pay tax to California only on their California taxable income. For more information, get FTB Pub. 1100, *Taxation of Nonresidents and Individuals Who Change Residency*.

Military Personnel – Servicemembers domiciled outside of California, and their spouses, may exclude the member's military compensation from gross income when computing the tax rate on nonmilitary income. Requirements for military servicemembers domiciled in California remain unchanged. Military servicemembers domiciled in California must include their military pay in total income. In addition, they must include their military pay in California source income when stationed in California. However, military pay is not California source income when a servicemember is permanently stationed outside of California. For more information, get FTB Pub. 1032, *Tax Information for Military Personnel*.

A Purpose

Interest expense paid by an individual, estate, or trust on a loan allocable to property held for investment may not be fully deductible in the current year. Use form FTB 3526 to figure the amount of investment interest expense deductible for the current year and the amount, if any, to carry forward to future years.

B Who Must File

If you are an individual, estate, or a trust and you claim a deduction for investment interest expense, you must complete and attach form FTB 3526 to your tax return.

Exception: You do not have to file form FTB 3526 if **all** of the following apply:

- Your only investment income was from interest or dividends.
- You have no other deductible expenses connected with the production of interest or dividends.
- Your investment interest expense is not more than your investment income.
- You have no disallowed investment interest expense from 2004.

Specific Instructions

Generally, California law for the investment interest expense deduction follows federal law. Get the instructions for federal Form 4952, Investment Interest Expense Deduction, for more information. Get federal Publication 550, Investment Income and Expenses, to determine your investment interest expense deduction if you have interest income or expense attributable to a working interest in oil or gas property or if you paid or accrued interest on a loan and you used the proceeds of the loan for more than one purpose.